

Report of the auditor-general to the Free State Legislature and the council on the Kopanong Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Kopanong Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South Africa Standards of Generally Recognised Accounting Practise (SA Standards of Grap) and the requirements of the Municipal Finance Management Act, 2003 (Act no. 56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (Dora) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Kopanong Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of Grap and the requirements of the MFMA and Dora.

Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

8. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material losses

9. As disclosed in note 46 to the financial statements, material electricity losses of R5 427 415 and water distribution losses of R16 285 378; were incurred by the municipality, mainly due to the aging electricity and water infrastructure.
10. As disclosed in note 20 to the financial statements, the municipality had foregone revenue of R23,5 million (2015: R14,1 million) due to the council's decision to discount tariffs during the financial year.
11. As disclosed in note 9 to the financial statements, material losses of R14 728 561 (2015: R6 916 164) were incurred as a result of a write-off of irrecoverable receivables from exchange transactions.

Material impairments

12. As disclosed in note 7 to the financial statements, receivables from non-exchange transactions were impaired by R15 207 530 (2015: R15 902 609) and, as disclosed in note 9 to the financial statements, receivables from exchange transactions were impaired by R124 812 509 (2015: R72 547 027).

Irregular expenditure

13. As disclosed in note 43 to the financial statements, the municipality incurred irregular expenditure of R19 210 921 (2015: R12 878 240) during the year due to non-compliance with supply chain management requirements. In addition, the full extent of irregular expenditure during the year was still in the process of being determined.

Fruitless and wasteful expenditure

14. As disclosed in note 42 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R19 155 122 (2015: R11 525 323) during the year due to interest and penalty charges on the late payment of suppliers.

Unauthorised expenditure

15. As disclosed in note 41 to the financial statements, the municipality incurred unauthorised expenditure of R95 552 998 (2015: R56 334 055) during the year due to expenditure that exceeded the limits provided for in the main divisions of the approved budget.

Going concern

16. The statement of financial performance indicates that the municipality incurred a deficit of R81 691 755 (2015: R71 164 145) during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R211 065 554 (2015: R149 381 940). In addition, the municipality owed Bloem Water R139 868 492 as at 30 June 2016, which was long overdue and was included with trade payables disclosed in note 14 to the financial statements. These conditions, along with other matters set forth in note 39, indicate a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

Additional matter

17. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

18. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Report on other legal and regulatory requirements

19. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on them.

Predetermined objectives

20. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas

presented in the annual performance report of the municipality for the year ended 30 June 2016:

- Service delivery and infrastructure development – technical services on pages xx to xx
- Service delivery and infrastructure development – community services on pages xx to xx

21. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
22. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
23. The material findings in respect of the selected key performance area are as follows:

Service delivery and infrastructure development – technical services

Usefulness of reported performance information

24. The FMPPI requires performance targets to be specific, in clearly identifying the nature and required level of performance, and measurable. A total of 100% of the targets were not specific.

Service delivery and infrastructure development – community services

Usefulness of reported performance information

25. The FMPPI requires performance targets to be specific, in clearly identifying the nature and required level of performance, and measurable. A total of 100% of the targets were not specific.

Additional matters

26. I draw attention to the following matters:

Achievement of planned targets

27. Refer to the annual performance report on pages xx to xx for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness of the reported performance information for the selected key performance areas reported in paragraphs 24 and 25 of this report.

Unaudited supplementary schedules

28. The supplementary information set out on pages xx to xx do not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report on them.

Compliance with legislation

29. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

30. The key performance indicators set by the municipality did not include indicators on the percentage of households with access to a basic level of water, sanitation, electricity and solid waste removal, as required by section 43(2) of the Municipal Systems Act and municipal planning and performance management regulation 10(a).
31. Sufficient appropriate audit evidence could not be obtained that the municipality developed and adopted appropriate systems (policies) and procedures to monitor, measure and evaluate staff performance, as required by section 67(d) of the Municipal Systems Act.

Financial statements

32. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of revenue, non-current assets, current assets, non-current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

Procurement and contract management

33. I could not obtain sufficient appropriate audit evidence that contracts were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding, as required by SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
34. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c).
35. Construction contracts were awarded to contractors that did not qualify for the contract, in contravention of section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).

Expenditure management

- 36. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA.
- 37. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
- 38. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
- 39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Conditional grants received

- 40. The municipal infrastructure grant allocation was not spent in accordance with the applicable grant framework, in contravention of section 17(1) of Dora.

Revenue management

- 41. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Assets management

- 42. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
- 43. Capital assets were permanently disposed without the approval of the council, as required by section 14(2)(a) of the MFMA.

Liability management

- 44. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA

Consequence management

- 45. Unauthorised expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
- 46. Irregular expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).

47. Fruitless and wasteful expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).

Internal control

48. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

49. The leadership did not sufficiently oversee financial and performance reporting and compliance and related internal controls, as it did not ensure that there were sound controls in the daily operations of the municipality.
50. There has been a slow response from leadership to implementing and monitoring the audit action plan to address qualification areas and internal control deficiencies identified during the previous audits. As a result, addressing these deficiencies was again a last minute effort to avoid audit report matters.
51. The leadership did not take effective steps to ensure that there were consequences for poor performance and transgressions, as none of the unauthorised, irregular, and fruitless and wasteful expenditure was investigated during the financial year.

Financial and performance management

52. Management did not implement proper record keeping and prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information. This was due to the lack of consequence management, for competent staff that did not perform in line with their responsibilities and level of competencies, at the financial department and in the performance information division.
53. The municipality did not prioritise the review and monitoring of compliance with legislation, which resulted in repeat findings being reported.
54. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. Numerous repeat findings were identified, which we communicated to the municipality and was corrected by management during the audit process. These corrections resulted in material amendments to the financial statements.

Governance

55. The effectiveness of the audit committee and internal audit was impeded, as could be seen from the issues identified by the audit not being given appropriate audit coverage. These issues were therefore unable to influence an improvement in the municipality's control environment. Furthermore, steps taken by management to address internal control

deficiencies and emerging audit risks identified in the previous audit were not adequately monitored.

Other reports

56. I draw attention to the following engagements that could potentially have an impact on the municipality's financial, performance and compliance-related matters. My opinion is not modified in respect of these engagements that are either in progress or have been completed.

Investigations

57. The municipality is still awaiting a report from the Special Investigations Unit (SIU) relating to several issues of non-compliance with the municipal policies. As reported previously, at the time of this report, the SIU did not report back to the municipality on these issues.

Auditor - General.

Bloemfontein

6 December 2016



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